

Consumer Savings

from Local Telephone Service Competition in Illinois

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TABLE OF CONTENTS

Introduction	1
Policy Background	2
Network Leasing is Essential to Competitive Local Telephone Service Markets	3
Estimate of Consumer Savings in 2002	4
Outlook for Customer Savings in 2003	6
Conclusion	7
Endnotes	8

A NOTE ON JARGON in federal and State telecommunications laws and rules. An incumbent monopoly local telephone service provider, like SBC or Verizon, is an "incumbent local exchange carrier" (ILEC), and any firm that seeks to compete with an ILEC is a "competitive local exchange carrier" (CLEC). ILECs are required by law to lease the various parts of their networks ("unbundled network elements" or "UNEs") to CLECs, and to lease UNEs in combinations to CLECs. The principal UNEs are "loops" that connect customers to the network, "switches" used to route calls to their destinations, "transport" links between switches, and network "signaling" services that direct the flows of messages. These four UNEs in combination are referred to as the UNE "platform," or "UNE-P." UNEs and combinations of UNEs are required by federal and State law to be offered at wholesale prices based on state-determined "economic, forward-looking" costs, and may not be based on historic monopoly accounting costs. Wholesale rates are determined by the "total element long run incremental cost" (TELRIC) cost estimation method, which includes a generous profit factor and a substantial contribution to ILEC overheads.

Introduction

Illinois residential consumers saved over \$130 million on telephone service in 2002 as a direct result of the introduction of competition in local service markets.¹ If existing rules for competition remain in place, Illinois households will save nearly \$300 million in 2003.

These are the findings of a study to determine the public benefits of passage and implementation of Illinois' landmark Telecommunications Act amendments of 2001.² Few State laws have ever contributed so large and immediate a consumer benefit. The members of ICCT gratefully acknowledge the debt of gratitude owed by all Illinois consumers to the policy leadership of the Ninety-second General Assembly and to the diligence of the Illinois Commerce Commission (ICC).

This study is unique in at least two important respects. First, the estimate of consumer cost savings presented here is based on empirical evidence of what customers in Illinois actually paid for telephone service. And second, this is the first such attempt in the nation to quantify the long-awaited benefits of competition in local telephone service markets.

Policy Background

The federal Telecommunications Act of 1996 (TA96) established the national goal of ending monopolies in local telephone service markets, and creating competition for all telecommunications services³. The states were tasked in that law with the bulk of implementation duties; and, during the first five years after passage, the ICC worked steadily through a number of lengthy and complex dockets attempting to enforce the local market-opening mandate and rules of TA96 for the benefit of Illinois consumers.

However, repeated refusals by SBC (and its predecessor, Ameritech) to comply with ICC orders frustrated the emergence of local market competition and delayed the benefits of customer choice⁴. At the end of 2000, nearly five years after passage of TA96, all of the companies trying to compete against SBC in the local market in Illinois had, as a group, less than a four percent (4%) share of the residential telephone service market.⁵

Fortunately, though, two events during the spring of 2001 ended this long impasse and laid the foundation on which competitive local telephone service markets have since finally begun to be built in Illinois. The United States Supreme Court issued a major decision in support of local competition using network leasing arrangements at lease rates based on fair forward-looking economic costs.⁶ And, soon thereafter, the General Assembly enacted explicit obligations in State law requiring SBC to open its local markets to competition, and gave the ICC substantially greater powers of enforcement to ensure compliance with that market-opening mandate.⁷

Subsequent investigations and hearings by the ICC led to several orders directing SBC to comply with the 2001 Act.

Network Leasing is Essential to Competitive Local Telephone Service Markets

The emergence of widespread competition in 2002 was made possible, because competitors finally obtained a fairly priced means of access to consumers in the mass market of households and small businesses: *network leasing*.⁸

Similar network leasing arrangements between carriers, which had been a common practice in the telecom industry for decades, allowed for the development of competition in the long distance industry during the 1980s. In fact, they are still prevalent in that industry today.⁹ New competitors in the long distance market, such as MCI and Sprint, began operations without owning any of their own facilities, but were able to offer service by leasing lines from AT&T at discounts against retail rates required by federal regulation. This arrangement, supported by FCC policy, allowed new entrants to long distance markets to establish sufficiently large customer bases and revenues to eventually secure financing to build their own networks.

The right of local market competitors to lease “unbundled network elements” (UNE), and combinations of UNEs, at just and reasonable rates was established in TA96. The Congress recognized that no new entrant to any of the nation’s local telephone service markets would have the capital necessary to recreate, or overbuild, the ubiquitous networks of incumbent monopolies like SBC or Verizon. So, it directed the FCC and the states to ensure that all UNEs necessary for the operations of competitors be supplied, and that rates for UNE leasing be based not on historic monopoly costs but on efficient economic pricing principles.

The subject of proper wholesale (lease) rate levels became a matter of concern to SBC as competition began to grow in 2002; and, at the end of the year, SBC filed a petition with the ICC to increase wholesale rate levels by several multiples. Although an analysis of wholesale pricing is outside the scope of this report, it is important for the reader to know two things about SBC's rate increase scheme. First, the current wholesale rates in Illinois – which were set by the ICC after lengthy, formal hearings in which SBC was a participant – are fully compensatory and consistent with legal requirements. The wholesale rates SBC has proposed are not based on efficient, forward-looking economic cost estimation principals as required by federal law and rules. And, second, if CLECs were required to pay the wholesale rates proposed by SBC, the competitive market in Illinois would collapse. Nothing can make this inevitable outcome clearer than the fact that SBC has proposed wholesale rates higher than its own retail prices.

Six years of determined governmental enforcement action were necessary to force SBC to achieve a minimal level of compliance with its legal obligation to lease UNEs at fair prices. Whether SBC will continue to try to find ways to resist competition policies and directives remains an important, unanswered question.

Estimate of Consumer Savings in 2002

The findings in this report are based on an analysis of a sample of more than 2,200 actual telephone bills of Illinois households drawn from a national database.¹⁰ Savings were estimated for the year 2002, and forecast for 2003, for households only, and do not include the ever greater levels of savings (estimated to average over \$1,000 per year) already being realized by small businesses.¹¹

Consumer savings from the introduction of competition come from two sources: (1) the lower average prices of CLEC services, and (2) price reductions made by SBC in response to competition from CLECs.

CLEC CUSTOMER SAVINGS

(1) Average Savings

The savings realized by CLEC customers was determined by comparing the average amount they paid for a basic set (or “package”) of services¹² with the average amount paid for a comparable set of service by SBC customers. This basic service package included local access and usage service, one or more calling features (e.g., call waiting, etc.), local (i.e., intraLATA¹³) toll service, and long distance (interLATA toll) service. The lower average amount paid by CLEC customers whose service packages did not include all of the services included in this basic package was eliminated from the analysis, thereby increasing the average amount paid by CLEC customers and reducing the amount of comparative savings — resulting in conservative cost savings estimate and projections. Similarly, amounts paid by both CLEC and SBC customers for “extra” services in addition to those included in the basic package were excluded to simplify the analysis without biasing the results.

Sample data, which covered the period from the third quarter of 2001 through the third quarter of 2002, were analyzed for each three-month period, and then averaged for the entire period to control for possible sampling abnormalities. The results of this analysis, which revealed an average monthly savings for CLEC customers of \$11.87, are presented in the table below:

Market Segment	Service Detail	Q3 2001	Q4 2001	Q1 2002	Q2 2002	Q3 2002	Average
SBC	Line & Local Usage & Features & Toll (incl. LD)	35.46	40.79	39.69	40.79	38.60	\$39.56
CLEC	Line & Local Usage & Features & Toll & LD	26.14	27.53	33.35	30.04	26.72	\$27.68
	CLEC Customer Savings	9.32	13.26	6.34	10.76	11.88	\$11.87

(2) Total CLEC Customer Savings

Total CLEC customer savings for the year 2002 were estimated by multiplying the average monthly savings amount by the monthly counts of CLEC residential customers served on UNE-P throughout the year.¹⁴ This produced a total savings figure of \$51 million.

SBC Customer Savings

All consumers – even those that continued to take service from SBC – benefited from CLEC market entry in 2002. Households that remained customers of SBC enjoyed cost savings as the result of two major price reductions made by SBC in response to competition.

In July 2002, SBC reduced customer charges by expanding local calling areas and lowering evening rates.¹⁵ The effect of these changes was observed in the local usage and toll portions of SBC customer bills reviewed in this study, and averaged \$3.62 per month. And, in early November, SBC announced price reductions in two of its most popular calling packages for a total of \$24 million dollars in annual consumer savings.¹⁶ This latter rate reduction, equally distributed across SBC's estimated residential customer lines¹⁷, produced an average monthly savings of approximately \$0.58.

The combined effect of July through October 2002 average savings of \$3.62 per month, and additional November-December savings of \$0.58 per month yielded total SBC customer savings in 2002 of \$80 million.

Combined Estimates of CLEC and SBC Customer Savings in 2002

$$\text{\$51 million (CLEC)} + \text{\$80 million (SBC)} = \text{\$131 million}$$

Outlook for Customer Savings in 2003

The forecast of customer savings presented here assumes no change in the amounts of average monthly customer savings realized by either CLEC customers (\$11.87) or customers retained by SBC (\$4.20). Although it obviously is possible that these figures might increase if competition intensifies, or decrease if competition is diminished by policy changes, this analysis does not attempt to predict the magnitude of any change in average customer savings.

Instead, this forecast is based primarily on a predicted level of growth in CLEC customer acquisition during 2003. And, again, it uses recent past experience as the guide. The monthly rate of growth in the number of customer lines served by CLECs ranged as high as thirteen percent, and averaged nine percent, during the second half of 2002. Although uncertainty also is attached to this variable in a forecast equation, this analysis assumes that the lesser, average rate of growth will obtain during 2003. The basis for this assumption is three-fold. First, the rate of CLEC customer acquisition continued to increase throughout 2002; thus, an assumption of no increase is a conservative one unlikely to bias future savings upward. Second, although the FCC is expected to make changes to the rules of competition in local telephone service markets early this year, the effect of those changes are both uncertain and likely to be delayed. And, third, SBC recently announced a very similar forecast of line losses in 2003 due to competition.¹⁸

Based on these *status quo* assumptions, anticipated residential customer savings in Illinois during 2003 are forecast to be:

$$\text{\$136 million (CLEC)} + \text{\$158 million (SBC)} = \text{\$294 million}$$

Conclusion

The passage and implementation of rules for competition embodied in the landmark Telecommunications Act amendments of 2001 laid the foundation for long-awaited competition in local telephone service in Illinois. The specific statutory obligations in the Act requiring SBC open its markets to competition and the enactment of substantially greater enforcement powers for the Illinois Commerce Commission are beginning to bear fruit for Illinois consumers.

This study shows that the advent of local phone competition that has resulted from the actions of the Illinois General Assembly and the ICC is saving Illinois consumers millions of dollars. And there is every reason to believe that these initial savings will grow as competition increases and reaches more and more consumers throughout the state.

Illinois policy makers should be proud of this State's rules for local telephone service competition. The merit of any proposed change to Illinois' telecommunications laws should be determined by its effect on the enormous consumer benefits those rules deliver.

ENDNOTES

- ¹ The results presented in this report describe household consumer savings in the Illinois service territories of SBC, but, due to lack of adequate data, do not include savings in the Verizon or other territories of incumbent, monopoly carriers.
- ² Public Law 92-22, effective June 30, 2001.
- ³ The federal Telecommunications Act of 1996 (TA96) authorizes competition in local service markets under the supervision of federal and state regulators. To make this possible, a local monopoly service provider like SBC (formerly Ameritech) is required to interconnect with and provide network services (at state-determined rates) to competing new market entrants seeking to offer service. If the historic monopoly provider meets a checklist of requirements to ensure that its local markets in a state are fully and irreversibly open to competition, TA96 allows it to apply to offer long distance service in that state. In the general scheme of TA96, the prospect of long-distance market entry serves as an incentive for the historic monopoly service provider to meet and comply with market-opening requirements.

TA96 established three pathways through which a new competitor could enter local service markets:

 1. Facilities-based entry (using its own facilities to provide local service);
 2. Resale (purchasing and reselling the services of the incumbent monopoly);
 3. Leasing (paying to use unbundled network elements (UNEs) supplied by the monopoly.

An incumbent monopoly (called "incumbent local exchange carrier," or ILEC, in TA96) must assist a facilities-based competitor to interconnect its network facilities with ILEC facilities for the exchange of communications between them. An ILEC is also required to offer its services for resale by competitors at a discount based on "avoided cost," usually about 15% below the ILEC's retail rates. And, an ILEC must lease UNEs and combinations of UNEs to competitors at efficient, forward-looking economic rates set by the state.

Congress established these three pathways expecting all to be used to bring competitive choices to all Americans. But experience during the past seven years has shown that the high costs of facilities-based, competitive entry make it economically feasible only in the niche markets of large volume telecom customers; and at available discount levels, resale is not an economically viable approach to market entry at all.

Thus, the vast majority of consumers, the "mass market" of households and small-to-mid-sized businesses, can be reached by new competitors in local service markets only through the leasing of facilities from ILECs.

A new competitive entrant in local service markets (called a "competitive local exchange carrier," or "CLEC," in TA96) is permitted to lease UNEs to combine with its own network facilities, and to lease combinations of UNEs to configure service offerings. The latter leasing arrangement is called "UNE-P" where the "P" stands for a "platform" sufficient to support competitive local market entry.
- ⁴ The fact sheet on the next page of this report, which chronicles the five-year history of refusals by SBC (Ameritech) to comply with ICC orders, was distributed in the General Assembly during consideration of telecom legislation in 2001:
- ⁵ "Local Telephone Competition: Status as of December 31, 2000, "Federal Communications Commission, Washington, D.C., May 2001.
- ⁶ Verizon Communications, Inc. v. Federal Communications Commission, 535 U.S. 467, 122 S.Ct. 1646 (2002).
- ⁷ Supra, note 2.
- ⁸ The analysis of the effect of competition on residential customer savings presented in this report considers only competitive service offerings provided via facilities leased from SBC, and in particular only UNE-P lease arrangements. See Endnote i for a general description of network leasing obligations of incumbent monopoly telephone service providers like SBC and Verizon.

- ⁹ The continuing resistance of SBC to leasing its network to competitors at fairly priced, forward-looking economic costs is ironic. In states where SBC and the other Regional Bell Operating Companies (i.e., Verizon, Bell South and Quest) have been authorized by the FCC to provide long distance service, they lease capacity from inter-exchange carriers like AT&T and WorldCom at discounts of 70 percent.
- ¹⁰ Data source: TNS Telecoms, Jenkintown, PA. Contact: Charles White, (267) 287-0111. TNS Telecoms is not affiliated with ICCT in any way and solely provided source data to an independent consulting firm for review and analysis. The conclusions drawn from this source data are in no way attributable to TNS Telecoms.
- ¹¹ "Business Telecom Users Benefit From Une-P-Based Competition, Selwyn and Gately, Economic and Technology, Inc.", December 2002.
- ¹² A simple comparison of the average CLEC customer bill with the average SBC customer bill would not reveal an accurate savings picture, because consumers purchase varying types and quantities of services. It is important to note, however, that the average amount paid by CLEC customers for the basic package of services reflects all variations in quantity purchases of usage-priced services, including unit charges for overages, preventing any downward bias in CLEC customer expenditures
- ¹³ Since SBC is prohibited by law from offering long distance (interLATA) service, it was necessary to add an amount charged for this service to the other amounts paid by SBC customers in order to make a comparison possible. This monthly charge of \$7.80 was conservatively estimated by multiplying the average minutes of use of interLATA toll service of all SBC consumers in the Illinois sample (82.7 minutes) by the average price paid per minute (\$0.094) for that service.
- ¹⁴ 2002 residential UNE-P line counts were based on monthly FCC Merger Compliance Reports filed by SBC. The residential portion of total UNE-P lines was determined by using the proportion of residential to total lines reported in FCC Docket 01-338.
- ¹⁵ "Local Phone Calls Revert to Five Cents. Flat rate applies up to 15 miles." Jon Van, Chicago Tribune, July 12, 2002.
- ¹⁶ SBC news release, November 7, 2002.
- ¹⁷ Estimates for 2002 and 2003 of total residential line counts were created by increasing 2001 line counts reported to the FCC (FCC ARMIS 4308) by three percent each year. SBC residential line counts were calculated by subtracting UNE-P residential line count estimates for each year.
- ¹⁸ SBC CEO Whitacre Turns Up Heat at FCC as Sales Slip" (Update3), Dana Cimilluca, Bloomberg News, 01/28/03 16:46.

WHY DOES ILLINOIS TRAIL THE NATION IN LOCAL COMPETITION?

1996	June 26th	Illinois Commerce Commission orders Ameritech to file the nation's first platform tariff enabling competitors to use a public network platform to provide competitive local telephone service
	Aug. 2nd	Ameritech refuses to file platform tariff.
	Aug 8th	FCC adopts Illinois platform as the national standard for developing local telephone competition
	Sept. 27th	Ameritech files platform tariff with direct violations of ICC order; Ameritech refuses to provide platform
	Nov. 7th	ICC opens first compliance proceeding against Ameritech
	Nov. 26th	ICC orders Ameritech to provide AT&T with platform; Ameritech refuses to provide platform
1997	Aug. 18th	FCC orders Ameritech to provide shared transport for platform; Ameritech refuses to obey FCC order
1998	Feb. 17th	ICC finds Ameritech in direct violation of explicit FCC & ICC Orders; ICC orders Ameritech to immediately provide platform
	April 3rd	Ameritech files tariff that again is in direct violation of ICC Order; Ameritech refuses to provide platform
	June 3rd	ICC opens second platform compliance proceeding against Ameritech
	Aug. 10th	US Court of Appeals orders Ameritech to provide shared transport for platform; Ameritech refuses to provide shared transport
	December	Verizon makes Illinois platform available in New York; 1 million consumers choose competitors; Ameritech refuses to provide platform
1999	Aug. 27th	SBC makes Illinois platform available in Texas; 569,000 consumers switch; Ameritech refuses to provide platform
	Sept. 23rd	ICC orders Ameritech to provide platform on terms offered in Texas as condition for approving SBC/Ameritech merger
	Oct. 8th	Ameritech files tariff 10 times SBC rate in Texas
	Dec. 25th	Ameritech admits that it is still not providing platform
2000	Oct. 8th	Ameritech files another platform tariff with direct violations of both the ICC platform compliance and the ICC SBC merger orders
	Nov. 1st	Illinois Commerce Commission begins a third platform compliance proceeding, over 4 years after issuing the nation's original platform order

- Ameritech has placed itself above Illinois law to State's detriment
- Ameritech vetoes Illinois statutes
- Ameritech vetoes ICC orders
- Ameritech makes record profits while local competitors' capital vanishes
- Illinois must amend the telecommunications law to implement and enforce the principles established as fundamental to creating local competition